



CHAIRMAN

Federal Communications Commission  
Washington, D.C.

December 2, 2004

The Honorable Edward J. Markey  
Ranking Member  
Subcommittee on Communications and the Internet  
Committee on Energy and Commerce  
U.S. House of Representatives  
2108 Rayburn House Office Building  
Washington, D.C. 20515

Dear Congressman Markey:

Thank you for your letter of October 28, 2004, regarding administration of the Universal Service provisions of the Communications Act, particularly the Schools and Libraries Universal Service Mechanism, commonly referred to as the E-rate program.

Providing high-quality telecommunications services to all Americans at affordable rates was a cornerstone of the Communications Act of 1934, and Congress reinforced this principle in the Telecommunications Act of 1996. Universal service has been an unqualified success in bringing telephone service to Americans. The Commission is committed to ensuring that the Universal Service Fund (USF) will continue to support ubiquitous and affordable telecommunications service for all.

We recognize that the question of whether Funding Commitment Decision Letters ("Commitment Letters") constitute "obligations" for federal budgetary accounting purposes under the Antideficiency Act has created unique challenges in the E-rate program. The Commission is committed to minimizing the impact of the Antideficiency Act on the programmatic decisions related to the USF and resuming new funding decisions as soon as practicable. USAC recently has resumed issuing Commitment Letters, sending out 194 Letters in a first wave last week. We anticipate that USAC will issue more this week, and we will continue to work closely with USAC to ensure that Commitment Letters are issued to program beneficiaries as expeditiously as possible.

I have attached answers to the specific questions raised in your letter. Thank you again for your interest in this important matter. Should you have any additional questions, please don't hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael K. Powell", with a stylized, flowing script.

Michael K. Powell

Enclosure

## Responses to Questions

*1. What was the financial status of the E-rate program when you decided to make the accounting change? Was there any risk that the program would not meet its funding commitments prior to your decision to change the accounting regime.*

We did not believe there were any significant risks that the USF program would be unable to meet its funding commitments. On September 30, 2003, around the time the accounting change was adopted in a Commission *Order*, USAC had an approximately \$2.569 billion balance available for the E-rate program. See Application of Generally Accepted Accounting Principles for Federal Agencies, *Order*, FCC 03-232, 19 FCC Rcd 19911 (2003), 69 FR 5718-01 (Feb. 6, 2004). One year later, USAC maintained a balance of approximately \$3.115 billion.

*2. What was your expectation as to the immediate, short-term financial effect of such a change? What was your expectation of the long-term financial effect of such a change?*

We expected no short-term or long-term effects from the change in terms of the Fund's financial ability to meet its commitments as a result of the application of government accounting standards.

*3. When you decided to make the change, did you expect committed funding to schools, libraries, and rural healthcare facilities to be withheld to conform with the accounting change?*

- a. If so, please explain the extent of such withholding you expected, and how you intended to rectify the shortfall.*
- b. If not, when did you become aware that your decision would lead to the withholding of funds? Please explain.*

At the time of the Commission's 2003 *Order*, we did not expect any withholding of funds to result. As is more fully explained in the answers to Questions 5 and 6 below, the subsequent withholding of funds resulted more directly from the Antideficiency Act. As explained in the response to Question 5, below, the application of government accounting standards simply highlighted possible existing deficiency problems.

*4. When you decided to make the accounting change, what was your expectation as to the effect of this change upon –*

- a. consumer ratepayers? Did you expect no change in consumer bills?*
- b. the range of advanced services available for funding support? Did you expect certain services would need to be dropped from the list of supported services or otherwise go unfunded for a period of time?*
- c. entities who had received commitment letter or who had pending applications for support? What notice did you give the public regarding your decision and what form did that notice take?*

We expected no change in consumer bills as a result of the accounting change. We expected no change in the range of services available for funding support as a result of the accounting change. The Commission *Order* in 2003 amending its rules to make clear that the USF and the

Telecommunications Relay Services Fund are required to comply with Federal Generally Accepted Accounting Principles (Federal GAAP) and United States Government Standard General Ledger (USGSGL) is a public document and was published in the Federal Register. *See Application of Generally Accepted Accounting Principles for Federal Agencies, Order, FCC 03-232, 19 FCC Rcd 19911 (2003), 69 FR 5718-01 (Feb. 6, 2004).* No parties appealed or filed petitions for reconsideration of the *Order*.

*5. What was the legal basis for making the accounting change?*

The decision to require the Universal Service Administrative Company (USAC) to adopt Federal Generally Accepted Accounting Principles (GAAP) for its financial statements was based on the need to bring the FCC into compliance with federal laws and Office of Management and Budget (OMB) requirements for financial reporting for federal agencies, and to respond to the material weaknesses identified in the Inspector General's 2002 audit.

Specifically, since 1999, the Commission has been required to prepare audited annual financial statements,<sup>1</sup> in compliance with Federal GAAP and to maintain its accounts according to the United States Government Standard General Ledger (USGSGL).<sup>2</sup> OMB's guidance also provides that when agencies issue consolidated financial statements that include components, GAAP for federal entities shall be applied to those components.<sup>3</sup> Because the Fund is included as a program in the FCC portion of the United States Budget, and has been since FY 1997, the Commission is required to include the Fund as a component of its financial statements.<sup>4</sup> Therefore, to ensure that the Commission complies with its obligations under federal financial management and reporting statutes and OMB directives, the Commission in 2003 amended its rules to make clear that the USF and the Telecommunications Relay Services Fund (also a component) are required to comply with Federal GAAP and USGSGL. *See Application of Generally Accepted Accounting Principles for Federal Agencies, Order, FCC 03-232, 19 FCC Rcd 19911 (2003).*

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<sup>1</sup> At the request of the Department of Treasury, the Commission prepared its first audited balance sheet in fiscal year 1999 and has prepared a complete set of audited financial statements since fiscal year 2000. Subsequently, the Commission was specifically included among agencies that were required to prepare annual financial statements under provisions of the Accountability of Tax Dollars Act of 2002, Public Law No. 107-289.

<sup>2</sup> Section 803 of the Federal Financial Management Improvement Act of 1996 (FFMIA) states that "[e]ach agency shall implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the [USGSGL] at the transaction level." *See* Section 803 of the FFMIA, *reprinted at* 31 U.S.C. § 3512 note (1996). *See also* Chief Financial Officer's Act of 1990, Public Law No. 101-576 and 31 U.S.C. § 3515(d) (OMB has authority to prescribe the form and content of financial statements); OMB Bulletin 01-09, Form and Content of Agency Financial Statements, Sept. 25, 2001 (OMB Bulletin).

<sup>3</sup> OMB Bulletin at 3.

<sup>4</sup> Pursuant to its authority to specify the form and content of agency financial statements, OMB requires all agencies to follow the Federal Accounting Standards Advisory Board's Statement of Financial Accounting Concepts No. 2 (SFFAC No. 2), which contains criteria for determining whether programs should be included on an agency's financial statement. Under SFFAC No. 2's conclusive criterion, programs and accounts listed on the United States Budget, such as the USF, must be included in an agency's financial statement.

The Commission action also served to address criticisms in the FCC Inspector General's audit of the FCC Fiscal Year 2002 Financial Statements, which had specifically identified under the "material weaknesses" section of the audit the fact that FCC components, including the USF, had not implemented Federal GAAP accounting, including budgetary accounting, and recommended implementation "to facilitate compliance with Federal financial reporting requirements."

The Antideficiency Act is a separate requirement that applies to all appropriated funds and thus has always applied to the USF. Specifically, OMB determined in 1996 that the USF should be included in the Budget of the United States and classified as a "special fund." See "Significant Presentation and Technical Changes in the Budget of the United States Government, Fiscal Year 1997," at p. 7, submitted to the Congress by OMB Director Alice M. Rivlin, March 19, 1996. In the federal budget, the Fund has been listed as a "mandatory appropriation" and as a "permanent appropriation." See, e.g. Budget of the United States Government, Fiscal Year 1997, Analytical Perspectives at 486; Budget of the United States Government, Fiscal Year 2001, Federal Programs by Agency and Account at 645. The Congressional Budget Office (CBO) has also noted that "CBO and the Office of Management and Budget (OMB) count payments into the Universal Service Fund as federal revenues and payments from the fund as federal outlays." Further, consistent with Universal Service Fund's budgetary status, OMB issued an apportionment for the USF for FY 2004, in accordance with the Antideficiency Act provision at 31 U.S.C. 1512(a), which requires apportionments of appropriations.

Because the USF has always been subject to the legal requirements of the Antideficiency Act, the Commission's October 2003 *Order* requiring USAC to use Federal GAAP was not the legal basis for imposing the requirements of the Antideficiency Act. However, during the conversion of USAC's books of account from commercial to federal government accounting standards, USAC's own accountants for the first time began to explore whether USAC's Funding Commitment Decision Letters (FCDLs) in the e-rate program needed to be treated as "obligations" under the accounting practices that apply to federal funds. Thereafter, in exploring that issue, concerns also began to arise that the Fund might need to take steps to avoid possible violations of the Antideficiency Act.

In August 2004, the Commission sought guidance from OMB as to the appropriate treatment of the FCDLs and any implications arising under the Antideficiency Act. In a September 8, 2004, meeting with OMB staff to discuss the matter, OMB advised both FCC and USAC staff that any investments of Universal Service funds are deemed to be "obligations" for federal budgetary purposes to the extent that such investments are non-Federal, as defined by Section 113 of *OMB Circular A-11*. OMB staff further advised that *OMB Circular A-11* requires that obligations of Universal Service funds may not exceed the cash balances on hand in the USF plus any such funds invested in Federal securities.

Until the conversion from commercial GAAP to Federal GAAP was underway, neither the Commission nor USAC was aware of the potential deficiency problems created by the manner in

which the Fund was operated and invested. Indeed, the FCC's financial statements, of which USF is a component, had received clean audits during prior fiscal years.

*6. Was this change made pursuant to a request from OMB? If so, was that request in writing and when was such request made?*

As explained in the answer to Question 5, the decision to require USAC to adopt Federal GAAP for its financial statements was based on the need to bring the FCC into compliance with federal laws and OMB and Treasury requirements for financial reporting for federal agencies and to respond to the material weaknesses identified in the Inspector General's 2002 audit.

The decisions relating to the applicability of the federal budgetary requirements, including the Antideficiency Act, to the USF were based on discussions with OMB staff and our review of written guidance previously issued by OMB, including *OMB Circular A-11*, relevant decisions of the Comptroller General concerning obligational documents like the FCDLs, and CBO's and OMB's prior written conclusions regarding the status of the Fund as appropriated funds. We concluded that these authorities, in conjunction with factual information provided by USAC concerning the Fund's cash balances and outstanding obligations, established the need to take action in order to avoid violating the Antideficiency Act. We were particularly concerned about ensuring compliance with the Antideficiency Act because it is a statute enforceable with criminal penalties. The timing of the FCC's decision was also driven by a need to complete its audited annual financial statement and to ensure, insofar as possible, that the FCC's year-end statement not reflect a deficiency under the Antideficiency Act. At the time of the FCC's decision, completion of the FCC's audited annual financial statement was proceeding rapidly in accordance with strict Government-wide timetables established by OMB.

*7. When you decided to make the accounting change for the E-rate program, what judgment did you make regarding the applicability of the same legal interpretation for the High Cost Fund or other universal service mechanisms?*

The legal requirement to use Federal GAAP applies to all of the programs of the USF. Similarly, the Commission's determination that the Antideficiency Act applied to the Fund includes all of the programs of the Fund. However, the point at which funds are "obligated" pursuant to federal budgetary accounting principles varies among the USF programs because their processes vary. As a result, the impact of the application of the Antideficiency Act on the operations of each program may be different. We are working with USAC to develop processes that will minimize, to the extent permissible under the law, any negative impact on the program's operations.

*8. Is it true that funding disbursed for other universal service programs, e.g., rural high cost funding, is often expended in anticipation of receiving funds collected from telecommunications carriers throughout the year? Please explain.*

No, it is not true. Funding for universal service programs is not expended until funds are received. However, collection decisions to cover anticipated program expenses are made when the contribution factor is determined by the Commission each quarter. Carriers and other contributors then make monthly contributions to the Fund based on the relevant quarter's contribution factor.

*9. Does USAC make rural high cost funding decisions on a quarterly or annual basis? Does USAC collect funds to meet such decisions on a quarterly or annual basis? Does USAC make expenditures in support of this program on a quarterly or annual basis? Please explain.*

High cost funding decisions are made on a monthly basis when disbursement decisions are made. USAC collects funds on a monthly basis from contributing carriers, based on the quarterly contribution factor established by the Commission. USAC makes disbursements in the high cost program on a monthly basis.

*10. Are universal service funds obligated for rural high cost support on the basis of actual or projected costs? Please explain.*

At this point, obligations in the high cost program are deemed to arise at the time of USAC's monthly disbursement decisions. Some disbursements are calculated based on actual costs, and some are based on projected costs, with a true-up at a later time.

*11. Please explain any distinctions in the collection, storage, and expenditure of universal service funds for the E-rate program, the rural healthcare program, the Rural High Cost Fund, and the Low Income Fund that may justify treating any one of them differently under your interpretation of the Antideficiency Act.*

As noted in the answer to Question 7, the Antideficiency Act applies to the Fund, including all of its programs. However, the point at which funds are "obligated" pursuant to federal budgetary accounting principles varies among the USF programs because their processes vary.

In the Schools and Libraries and Rural Healthcare programs, based on our review of the facts, the governing law, and our conversations with the Office of the General Counsel of OMB, we concluded that FCDLs are "obligations" within the meaning of 31 U.S.C. § 1501(a)(5)(A),(B) ("The Recording Statute")(an amount must be recorded as an obligation when there is documentary evidence of a grant or subsidy payable from appropriations).

In the High Cost and Low Income support programs, there is no specific obligational document equivalent to the FCDL. As a result, a determination of the point of obligation in those programs is more complex. Based on consultation with Treasury and OMB, the Commission's FY 2004 audited financial statements are consistent with this approach. We have also sought OMB's guidance on this question.

*12. When do you expect funding for E-rate recipients to be restored and when can entities whose funding has been suspended expect to receive funds?*

As we have stated publicly, there has never been a problem with the issuance of funds already committed – USAC has had ample funds to cover invoices as the beneficiaries have submitted them. Rather, USAC had to suspend any further funding commitments. USAC recently has resumed issuing Commitment Letters, sending out 194 Letters in a first wave last week. We anticipate that USAC will issue more this week, and we will continue to work closely with USAC to ensure that Commitment Letters are issued to program beneficiaries as expeditiously as possible.